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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of)

Federal-State Joint Board on)
Universal Service)

CC Docket No. 96-45

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**COMMENTS OF CITIZENS UTILITIES COMPANY ON THE
FEDERAL-STATE JOINT BOARD'S UNIVERSAL SERVICE
RECOMMENDED DECISION**

CITIZENS UTILITIES COMPANY

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Summary

The Citizens Companies endorse the Joint Board's proposed classification of high cost area and low-income customer supportable services and multi-year transition period for rural local exchange carriers' movement to cost proxies for high-cost funding determination. They are less sanguine, however, about other major features of the Joint Board Recommendations. They are deeply concerned that the Joint Board Recommendations evidence little, if any, consideration of the overall cost of the new universal service system or the impact of that cost upon the demand for telecommunications services. Great care must be taken to ensure that the system does not become so encrusted with the burden of financing universal service entitlements that demand for telecommunications services is dampened.

The Joint Board Recommendations' proposed treatment of discounts to schools and libraries is an example of the Joint Board's failure to balance politically popular social goals with economic reality. The proposed inclusion of Internet access and internal connections in the list of supportable services for schools and libraries, while laudable, is also beyond the scope of the applicable statute. The artificially inflated cap of \$2.25 billion dollars for school and library services recommended by the Joint Board is inflated by services that are not supportable telecommunications services, and would essentially create a guaranteed funding amount.

The Citizens Companies, while endorsing most of the proposed, revised federal Lifeline program, suggest a modification that requires state participation in order to secure federal funding beyond a baseline federal contribution of \$3.50 per qualifying subscriber, up to a maximum federal contribution of \$5.25.

The Joint Board's proposals for the federal subscriber line charge are unsound and should be rejected.

Contrary to the Joint Board's proposal, the federal benchmark for high cost funding should be a function of a national average rate for universal services, plus one standard deviation. The Joint Board's proposed national revenues standard for allocating federal funds is unsound and unworkable.

Finally, no real determination can be made at this time whether the federal fund should "tax" both state and federal revenues. That determination can be made only after quantification of the costs of the new universal system, at all jurisdictional levels, is made. The Citizens Companies believe that taxing of bi-jurisdictional revenues may, however, be appropriate to ensure a broad tax base. Contrary to the Joint Board's conclusion, the tax base should, in the interest of competitive neutrality, be carriers' retail revenues.

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**COMMENTS OF CITIZENS UTILITIES COMPANY ON THE
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RECOMMENDED DECISION**

Citizens Utilities Company, on behalf of itself and its telecommunications divisions and subsidiaries (hereinafter referred to, collectively, as the "Citizens Companies"), by its attorney, hereby submits its comments on the Federal-State Joint Board's Universal Service Recommended Decision, released November 8, 1996 (the "*Joint Board Recommendations*"), and shows as follows:

I. Introduction

Citizens Utilities Company, through divisions and subsidiaries, provides telecommunications services, electric distribution, natural gas transmission and distribution, and water and waste water treatment services to more than 1,600,000 customer connections in 20 states. The Citizens Companies' Telecommunications Sector provides local exchange telephone services in suburban and rural exchange areas in Arizona, California, Idaho, Montana, Nevada, New Mexico, New York, Oregon, Pennsylvania, Tennessee, Utah and West Virginia. In addition, Citizens Telecommunications Company, a Citizens' subsidiary, provides interexchange services throughout the nation and competitive local exchange services in several states. Finally, another Citizens' subsidiary, Electric Lightwave, Inc., provides competitive local exchange and interexchange services in Arizona, California, Idaho, Minnesota, Nevada, Oregon, Washington, and Utah.

The Citizens Companies are a microcosm of the telecommunications industry. The Citizens Companies include incumbent local exchange companies serving areas of 12 states, a long distance carrier and competitive exchange carriers. As such, the Citizens Companies strive to reach a balance of competing interests in forming regulatory positions and strategies. The balanced perspective of the Citizens Companies on universal service issues leads it to endorse many key parts of the *Joint Board Recommendations*. In particular, the Citizens Companies endorse the Joint Board's proposed classification of high cost area and low-income customer supportable services and the multi-year transition period for rural local exchange carriers' movement to cost proxies for high-cost funding determination.

The Citizens Companies are less sanguine about other major features of the *Joint Board Recommendations*. In particular, they are deeply concerned that the *Joint Board Recommendations* evidence little, if any, consideration of the anticipated, overall cost of the new universal service system or the potential impact of that cost upon demand for telecommunications services. Telecommunications service revenues are the Congressionally-mandated source of funding the new universal service system. This new universal service system will not only replace the existing high cost and low income programs, but will also fund new classes of services and customer classes. As a result, the Joint Board and the Commission are embarked upon a much greater task, with more far reaching consequences, than in previous efforts at universal service reform. Accordingly, great care must be taken to ensure that the system does not become so encrusted with the burden of financing universal service entitlements^{1/} that demand for telecommunications services is dampened.

^{1/} Fully recognizing that the term "entitlements" is a politically sensitive expression, the
(continued...)

The Citizens Companies view the *Joint Board Recommendations*¹ proposed treatment of discounts to schools and libraries as an example of the Joint Board's failure to balance politically popular social goals with economic reality. The proposed inclusion of Internet access and internal connections in the list of supportable services for schools and libraries, while laudable, is also beyond the scope of the applicable statute. The potential cost of supporting these non-telecommunications services, in addition to the potential cost of supporting the telecommunications services that are supposed to be included, led the Joint Board to suggest a very high spending cap. Spending caps for school and library discounts and rural health care services are vital; there is no way to quantify, at this point, the anticipated demand for the discounts. However, caps for these categories of universal service will also function, in actual practice, as target amounts that recipients will vie to receive. The artificially inflated cap of \$2.25 billion dollars for school and library services recommended by the Joint Board, for example, would essentially create a guaranteed funding amount. In light of the fact that significant portions of the new universal service program remain unquantified at this point, great care must be taken in setting caps or targeted support amounts for specific components of the program.

These comments will focus on those subject areas of the *Joint Board Recommendations* where the Citizens Companies have significant concerns. In each subject area discussed below, the

¹-(...continued)

Citizens Companies chose it carefully for use in these comments. It is being used in these comments to connote rights that, once created by statute or administrative regulation, become so entrenched in the political economy that alteration or elimination, even when necessary, becomes exceedingly difficult, if not impossible. Entitlements, in this sense, tend to take on a life of their own even when they have outlived their original purpose or have become unsustainable.

Citizens Companies believe that substantial, additional work must be done to ensure viability and sustainability of the new universal service system.

II. The Core Concern of the Citizens Companies: Possible Drift to a New, Unlimited Entitlements Program

Among the animating concepts of Section 254 of the Communications Act of 1934, as amended, 47 USC §254 (hereinafter referred to as "Section 254"), are the requirements that universal service support be specific, predictable, sufficient^{2-/} and explicit.^{3-/} In the view of the Citizens Companies, these requirements connote the direct involvement of all "stake holders" in the underlying transactions. The fundamental stake holder in any newly structured universal service program is the consumer of telecommunications services. Consumers of supported telecommunications services are the beneficiaries of the program. However, the Commission must never lose sight of the fact that the ultimate funding source of any universal service program is the group of consumers that generate the telecommunications carriers' revenues funding the program.

It is consumers, both residential and commercial, that ultimately will bear the burden of this program in the prices they pay their carriers. However, the *Joint Board Recommendations* do not address the core issue of what the new program may cost the consuming public and what the resultant impact may be. The Joint Board's failure to join the issue of the potential size of the new universal service fund and its potential impact upon the ultimate consumers of telecommunications services is a fundamental flaw. The Commission must correct this flaw in its final disposition of the intensely political set of universal service issues presented in fulfilling its Section 254 obligations.

^{2-/} See Section 254(d).

^{3-/} See Section 254(e).

The Citizens Companies believe that the requirement that universal service support be made explicit exists on at least two levels. First, it means that the present implicit funding arrangements, including those embedded in incumbent local exchange carriers' rate structures, must terminate and be replaced by explicit contributions by all telecommunications carriers. A critical determination is defining the services that should be funded by carrier contributions and the amount of funding that should be provided. Second, and more subtly, the consuming public, as a major stake holder in the universal service system, requires some explicit quantification of the overall cost of the system and analysis of the impact of that cost upon the prices of the telecommunications services they purchase. The Citizens Companies view the *Joint Board Recommendations* as dwelling upon only one piece of the universal service puzzle -- what services should be supported -- without addressing the critical issues of the ultimate cost of supporting these services and the impact upon the consuming public.

Much of the economic and political difficulty the Nation finds itself in today stems from the expediency of a seemingly beneficent government bestowing benefits upon the public without contemporaneous consideration of taxpayer impact. Often, only after those benefits become ingrained in the public mind, do their true cost and impact upon the economy and taxpayers become apparent. By that time, the political will required to take corrective action can usually not be mustered. The Citizens Companies do not wish to see the new universal service program proceed down the same path.

The *Joint Board Recommendations* portray a new type of entitlements program being created without regard to its impact upon the economy and consumers. The Citizens Companies find no mention in the *Joint Board Recommendations* of what the total costs of the new universal service system might be. Similarly, they find no evidence of consideration of potential impact upon the

ultimate supporters of the new system -- the consumers of telecommunications services. Perhaps most troubling of all, there is no acknowledgement of the unavoidable fact that it is telecommunications services consumers who will ultimately bear those universal service costs. As Commissioner Chong pointed out in her Separate Statement issued with the *Joint Board Recommendations*:

Finally, I strike a note of caution. I have serious concerns about the total size of the universal service program that the Commission will put in place next May. At this time, with both the high cost and health care portions of our universal scheme uncompleted, we are not able to get a handle on the total size of the universal service fund pursuant to the broad framework that we set up today. Preliminary data shows that this may result in a multi-billion dollar program, part of which replaces our more modest existing universal service system and part of which replaces the current implicit/explicit subsidy system of the past.

The final price tag for the federal universal service program could well be in the range of billions of dollars. Two competing interests must be balanced here: the advancement of universal service goals versus the impact that a huge fund may have on the bills of telecommunications users, particularly low income individuals. *Let us make no mistake about who will foot the bill for this universal service program. It is not the telecommunications carriers, but the users of telecommunications services to whom these costs will be passed through in a competitive marketplace.* Thus, I reserve all judgement about whether the framework we have set forth today is a wise one, until I obtain and study final estimates of the total size of the fund. I remain cognizant that any program we put in place must contain 'specific, predictable and sufficient' mechanisms. [footnote omitted]

In the Telecommunications Act of 1996, Congress delegated to the Commission and the states the ultimate decision on whether the new universal service system should be a focused, managed program or, instead, be allowed to become another uncontrolled entitlements program. As "no free lunch" is to be had ultimately in structuring a new universal service system, a concerted effort must be made to ensure that burgeoning demand for ever more sophisticated telecommunications services is not stifled by imposition of an unreasonably burdensome universal

service "tax" load. Accordingly, the *Joint Board Recommendations* should be viewed as addressing only one part of the universal service equation -- the services that should be supported. As such, much work is left to be done in order to achieve the necessary balance of competing interests called for by Commissioner Chong in her separate statement.

The appropriate starting point in determining the potential cost of a new universal service system is ascertaining, as accurately as possible, what universal service costs today. Given the current tangle of implicit and some explicit funding inherent in the historic universal service scheme, this will be difficult. For example, what is the total amount of implicit subsidy flow inherent in today's interstate access charge structure? What is the total amount of implicit subsidy flow inherent in today's intrastate access charge structures? What is the total amount of implicit subsidy flow inherent in today's pricing of nonresidential local exchange services? As vexing and difficult as these questions are, they must be addressed in order to determine what is currently being subsidized and whether the same level is viable in a competitive environment. These fundamental questions must be addressed in the Commission's oft-delayed access reform proceeding as part of enlightened decision making on universal service issues and to allow incumbent local exchange carriers to rationalize their access structures to face a competitive marketplace.^{4/}

Next, a determination must be made of what the new universal service regime will cost at both the state and federal levels. Because the ultimate payers for telecommunications services -- the

^{4/} Answering these questions is also fundamental to state commissions in determining the degree to which local exchange carriers should be allowed to rebalance their local exchange rates. The issue of local exchange rate rebalancing is critical in the states' ascertainment of how to eliminate implicit subsidies. The resolution of this issue will have profound consequences for state universal service funding and the overall size of the total pot of state and federal funds that must be generated by contributions from telecommunications carriers.

consuming public -- generally purchase both intra- and interstate services, they will ultimately bear bi-jurisdictional universal service costs. The historical experience under the past federal and state universal service systems should be helpful as a starting point in this determination. Once this is done, the necessary political decisions can in balancing the benefits of the new system, as proposed, with the possible detriment that may flow to the consuming public that ultimately pays for universal service support. The possible detriment to the consuming public is that the costs of universal service, if left uncontrolled, could stifle demand for telecommunications services that will serve as the "tax" base for the new universal service system. Consumers of telecommunications services, once the costs of an overburdened universal service system are passed through, are likely to purchase fewer or a lesser amount of such services. Further, under such circumstances, telecommunications carriers may reevaluate whether competitive entry into new markets is viable when margins may possibly be consumed by subsidy support obligations.

Despite raising the specter of the universal service system becoming another unmanageable entitlements program, the Citizens Companies are not opposed to achievement of any of the universal service goals expressed in Section 254. Indeed, the Citizens Companies' incumbent local exchange carriers, as carriers serving customers in high cost areas, have historically been recipients of universal service funding under the old universal service regime and expect to continue to be so under the new regime. It is also correct that the customers of the Citizens Companies, like all telecommunications service consumers, will ultimately share in the costs of the new universal service program.^{5/} The Citizens Companies' concerns with the *Joint Board Recommendations* are

^{5/} *Joint Board Recommendations* at ¶ 813 ("[W]e agree with commenters that suggest that (continued...)

driven by the Joint Board's failure to consider the overall costs of its proposals and the potential impact of those costs upon the consuming public that will ultimately bear them. The economic feasibility of the *Joint Board Recommendations* is wholly unknown at this point. Rational decision making in this most complex of proceedings, however, dictates that the benefits of a new universal service system cannot be adequately measured without consideration of the possible burdens that follow.

The Joint Board's failure to explore the possible costs of the new universal system and the resulting impact upon telecommunications consumers is difficult to understand, given the great deal of data available to it. It has been provided with estimates of the cost of universal service in high cost, rural and insular areas from sources as diverse as USTA and MCI. Neither that data nor the underlying methodologies and assumptions are analyzed, much less mentioned, in the *Joint Board Recommendations*. Further, the Joint Board did not comment upon, nor refer to, the data provided in response to the Commission's late-1994 data request to incumbent local exchange carriers in Docket No. 80-286. The *Joint Board Recommendations* seem to exist in isolation from this mountain of evidence still awaiting public review and analysis.

The Citizens Companies believe that an overly adorned universal service "Christmas tree" will hurt the consuming and carrier public alike by diminishing demand for the telecommunications services that will serve as the "tax" base for universal service funding. Ultimately, the cause of

^{5/}(...continued)

carriers should receive credits against their contributions [to the universal service fund] for services provided to rural, insular or high cost areas, schools and libraries or health care providers at below cost."). The *Joint Board Recommendations* contemplate a netting of the value of a carrier's provision of universal service against its contributions to the support of that service.

universal service, if allowed to devolve into an uncontrolled entitlements program, could be diminished if its base of support -- telecommunications services consumption -- is unnecessarily eroded. The Commission must do what the Joint Board avoided -- undertake the balancing of competing interests highlighted by Commissioner Chong in her separate statement. Substantial information has already been provided to the FCC that can be used as the starting point for analysis in pursuing the necessary balance of competing interests.

The issue of affordability of universal services is not limited in scope to the immediate prices consumers pay for those services. Affordability of telecommunications services must also be viewed on a macroeconomic level. Because the new universal service system will have effects far beyond those focused upon telecommunications service providers and their customers, the impact of the new universal service system on the overall economy must be considered. For example, the new universal service system includes educational institutions, libraries and rural health care providers as beneficiaries. These classes of customers do not exist in isolation from the general economy. These classes of customers, like all participants in the Nation's economy, are increasingly dependent upon telecommunications infrastructure as a necessity in the evolving information economy. An ill-advised, overburdened universal service system could actually cause long run harm to these beneficiaries and the entire economy if the telecommunications infrastructure cannot support the attendant costs. The Joint Board failed to consider such macroeconomic issues.

III. *The Joint Board Recommendations'* Proposed Treatment of the Funding of Discounts to Eligible Schools and Libraries

The *Joint Board Recommendations'* proposed treatment of the funding of discounts to eligible schools and libraries illustrates the potential for laudable goals leading to unsustainable

results. The flaws contained in the Joint Board's proposals for funding of discounts to schools and libraries are the proposed inclusion of Internet access services and internal connections, respectively, in the class of services eligible for funded discounts. The proposed creation of an annual \$2.25 billion "cap" on funding for discounts to eligible schools and libraries, while seemingly evidence of an effort at fiscal restraint, is actually a serious flaw. As shown below, the inclusion of Internet access and internal connection funding is contrary to Sections 254(h)(1)(B) and 254(h)(2)(A) and only serves to inflate the total requirement for funding services to schools and libraries. Further, it is reasonably easy to predict that the cap, inflated as it is by services not properly includable in the services to be supported, will be treated as the *de facto* pot of dollars that will be pursued by eligible entities.

A. The Proposed Inclusion of Internet Access

Section 254(h)(2)(A) states that "[t]he Commission shall establish competitively neutral rules to enhance, to the extent technically feasible and economically reasonable, access to advanced telecommunications and information services for all public and non-profit elementary and secondary school classrooms . . . and libraries. [emphasis added]"^{6/} Unlike the Joint Board, the Citizens Companies do not believe that Section 254(h)(2)(A) expands beyond telecommunications services the class of services to be provided at discounts to eligible schools and libraries. The Joint Board's reading of this statutory provision, if sustained, would write in a meaning not intended by Congress in its plain and simple directive. Section 254(h)(2)(A) means exactly what it says: the Commission must promulgate rules ensuring that advanced telecommunications services and information services

^{6/} *Id.* at ¶ 441.

are made available to eligible schools and libraries. When read in context with Section 254(h)(2)(B), it is clear that "access" is meant to be the means of physical connection, via a telecommunications service, between schools and libraries and advanced telecommunications services and information services. Section 254(h)(2)(A) cannot be contorted to support the reading given to it by the Joint Board.

Section 254(c)(1), which defines universal service, in general, unequivocally states that "[u]niversal service is an evolving level of *telecommunications services* [emphasis added]" While advances in "information" technologies, along with advances in "telecommunications" technologies, are to be taken into account in defining universal service, nothing in Section 254(c)(1) suggests that information services are included within the universal service definition. Further, Section 254(c)(3) authorizes the designation of "services," in addition to the core universal services determined under Section 254(c)(1), as support-eligible when provided to schools, libraries and health care providers under Section 254(h). In the view of the Citizens Companies, Section 254(c)(3) must be read *in pari materia* with Section 254(c)(1). Section 254(c)(3) cannot be construed to expand support-eligible services to schools, libraries and health care providers beyond the "telecommunications services" specified in Section 254(c)(1) as the essence of universal service. Had Congress intended to include information services, such as Internet access, as services supportable by universal service funding, it would have specifically done so.

Recognizing the intellectual hurdle presented by use of the words "access to" in connection with Section 254(h)(2)(A)'s reference to information services,⁷¹ the Joint Board attempts to justify

⁷¹ Cf. Section 254(h)(1)(B), which clearly makes discounts available only on
(continued...)

extension of discounts to Internet access services with the contention that "[a]ny attempt to disaggregate the network transmission component of Internet access from the information service component could serve to undermine the Internet access market at this time."^{8/} The Joint Board's unclear logic suggests that Internet access providers are so like telecommunications service providers, because of their use of transport facilities, that they should be treated like telecommunications carriers under Section 254(h)(2)(A). If, by this conclusion, the Joint Board means that the analytical tools do not exist to distinguish between a basic telecommunications service, or even an adjunct to a basic service, and an information service, it is wrong. *See North American Telecommunications Ass'n.*, 101 FCC 2d 349 (1985), *recon. denied*, 3 FCC Rcd 4385 (1988). *See, also Southwestern Bell Telephone Co.*, 5 FCC Rcd 379 (1990); *US West Communications, Inc.*, 11 FCC Rcd 1195 (1995).

It should also be noted that the Joint Board did not have much difficulty in making the fundamental distinction between a "service" and "access" to that service in other contexts. For example, access to interexchange service, meaning the ability to place and receive interexchange calls, but not usage of interexchange services, was recommended for inclusion in the definition of universal service.^{9/} Similarly, access to directory assistance services, but not the service itself, was recommended for inclusion in the definition of universal service.^{10/} In both instances, the access

^{7/}(...continued)
telecommunications services.

^{8/} *Joint Board Recommendations* at ¶ 462.

^{9/} *Id.* at ¶ 65 and fn. 193.

^{10/} *Id.* at ¶ 67.

or platform function of the customer link to the transmission network was severed, for analytical purposes, from the services that could be obtained over that loop. The same logic suggests that the service provided by a telecommunications carrier in access to the Internet can be severed from the services that the Internet access provider extends over the telecommunications carrier's transmission facility. It is only the latter facility that should, under Section 254(h), be the subject of funded discounts.

If, however, the Commission finds the Joint Board's conclusion on this issue to be correct, it inescapably follows that Internet access providers are no longer properly classifiable as information service providers. Two salutary implications flow from reclassification of Internet access providers as telecommunications service providers: (1) they would be required to contribute to universal service funding under Section 254(d); and (2) they would be responsible for the payment of access charges, where their services are interexchange in nature, and reciprocal compensation, where their services are local exchange in nature.

In the event that the Commission is not prepared to endorse the proposition that Internet access services are properly includable in the statutory definition of telecommunications services, then those services should be excluded from services eligible for funded discounts to qualifying schools and libraries. Pursuant to the statute, services that are not telecommunications services are not eligible for funded discounts. Holding otherwise would incorrectly add incalculable pressure upon overall federal funding requirements.

B. Internal Connections

The *Joint Board Recommendations*' suggested inclusion of internal connections in the pot of school and library services eligible for funded discounts is more a product of political and social

desirability than of logic and the law. The Joint Board relies on much the same flawed logic in support of inclusion of internal connections that it relies upon for inclusion of Internet access. At least in the case of Internet access, the service involves mixed use of a telecommunications service and an information service. This is not the case with internal connections. The question is not whether installation and maintenance of internal connection is a "service," as the Joint Board believes is dispositive.^{11-/} The question is whether it is a telecommunications service eligible for funding. It clearly is not.

The Joint Board is correct that internal connections enhance school and library connection to advanced telecommunications and information services. However, so do computers and software. Yet, the Joint Board proposes that computers and, presumably, software not be funded, without explaining how they are any less indispensable in enhancing access to enhanced telecommunications and information services than are routers, hubs, network file servers, and wireless LANs, which are the subject of proposed funding.^{12-/} Apparently, even the Joint Board sees merit in some limit to what is funded under the "enhancing access" proposition. As elusive as the Joint Board's logic might be in deciding what internal connections fit within the "enhancing access" proposition and which do not, one thing is clear -- support of any internal connections will load significant costs upon the universal service system that are not contemplated under the statute.

The Joint Board's recommended inclusion of internal connections in the class of services eligible for discount funding should be denied. Section 254(h) does not support a construction that

^{11-/} *Id.* at ¶ 474.

^{12-/} *Id.* at ¶ 477.

allows funding of non-telecommunications services. The net result of inclusion of such services in the class eligible for funded discounts can only be to add to a universal service fund that, in the absence of critical examination, may quickly burgeon out of control.

C. The "Cap" on School and Library Discount Funding

The Citizens Companies must point out, at the outset, that they fully embrace a cap upon school and library funding. As the Joint Board states:

Unlike high cost assistance, long-term support, and DEM weighting, there is no historical record of how much it will likely cost to provide the support Congress directed us to afford to schools and libraries . . . [t]o fulfill our statutory obligation to create a specific, predictable, and sufficient universal service support mechanism, we recommend that the Commission establish an annual cap on the amount of funds available to schools and libraries.^{13./}

It is not the idea of a cap, *per se*, that troubles the Citizens Companies. A cap is vitally important both in controlling the size of this component of the federal fund and in ensuring the states' opportunity under Section 254(f) to fund discount programs of their own.^{14./} Instead the concern is with the construction of the particular cap recommended by the Joint Board. After improperly inflating the amount of funding that may be required by recommending inclusion of Internet access and internal connections as services eligible for funding discounts, the Joint Board engaged in what was essentially guess work in arriving at a \$2.25 billion annual cap on school and library funding. Human nature being what it is, this artificially inflated cap will, in fact, become the funding floor

^{13./} *Id.* at ¶ 552. While the Citizens Companies fully agree with the Joint Board's recommendation in this regard, they find it exceedingly hard to reconcile the recommendation with the proposed inclusion of Internet access and internal connection services in the class of supported services.

^{14./} A cap is also vital, for the same reasons, upon funding of services to rural health care providers.

or target figure that will be pursued by potential recipients. It is highly probable that this cap will, in and of itself, become the dollar value of a politically untouchable entitlement.

To avoid an artificial stifling of demand for the telecommunications services that will be the funding source for all universal service support, including that to schools and libraries, it is vitally important that the Commission take the necessary steps to control the size of the program. Insofar as school and library support is concerned, the cap on funding should, at a minimum, be reduced below the recommended \$2.25 billion per year by removing Internet Access and internal connections from the class of services eligible for funding.

Lowering the federal cap will have another salutary effect -- a tighter focusing of available federal benefits to the neediest schools in the highest cost areas. In the view of the Citizens Companies, the benefits of the federal school and library services funding programs should go most heavily to those institutions where the need is the greatest. Lowering the cap would also encourage the states to fund their own discount programs for services to schools and libraries, if they so elect. It should be noted that Section 254(h)(1)(B) contemplates dual state and federal programs for schools and libraries.

D. Existing Special Rates for Schools and Libraries

The Joint Board suggests that existing special rates that may have been negotiated between carriers and schools and libraries or secured through state action can function as base rates for the application of Section 254(h) discounts.^{15_1} This otherwise sound suggestion does not contemplate the situation in which an incumbent local exchange carrier agreed to a level of below-cost rates for

^{15_1} *Joint Board Recommendations* at ¶ 571.

a defined subset of schools and libraries, such as all elementary schools in a service area, as part of a negotiated resolution of a state commission's earnings investigation. In this case, it would be neither fair nor appropriate to use those rates as the pre-discount price for all schools and libraries in an affected carrier's service area. Those rates are not related to the carrier's cost of providing service. Instead, they are related solely to a bargained arrangement to settle an overearnings issue in an investigation or rate case.

Rates to a defined subset of schools and libraries resulting from settlement of an earnings investigation are not analogous to the private contract rates discussed in paragraph 572 of the *Joint Board Recommendations*. While the level of rates of concern to the Citizens Companies in this context were bargained, they were bargained between a carrier and its regulator as part of settlement of overearnings claims, rather than bargained in the conventional, commercial sense. As such, the carrier-regulator bargaining may have had nothing to do with the carrier's recovery of its costs of the bargained service. The Citizens Companies believe that rates resulting from settlement of an earnings investigation are properly limited in scope to the bargain between the carrier and its regulators and bear no relation to an appropriate pre-discount price for any school or library not within the scope of that regulatory bargain. To hold otherwise would be to deny the carrier the benefit of its bargain by reducing its earnings below the amount agreed upon with the regulator. This is so because the agreed upon, below-cost services would be extended beyond the scope of beneficiaries contemplated at the time the bargain was struck.

IV. Low-Income Support

The Citizens Companies fully support the Joint Board's recommendation that Lifeline support be extended to all states.^{16/} However, they do not share the Joint Board's reluctance to suggest some form of mandatory participation by the states and the telecommunications industry in funding the expanded Lifeline program.^{17/} The proposal is to increase federal funding to \$5.25 per qualifying subscriber without requiring any exercise of responsibility by the states. As structured, the Joint Board's proposals in this regard potentially impose too high a burden upon the overall size of the federal universal service fund and unduly relieve the states of their responsibilities.

Section 254(f) clearly preserves the states' opportunity to promulgate universal service programs at their jurisdictional level. Accordingly, the Citizens Companies suggest modification of the recommended program. First, every state should receive baseline federal Lifeline support of \$3.50 per qualified subscriber. Then, each state should, as a condition precedent to receiving the maximum \$5.25 per subscriber federal support, be required to fund \$1.75 per qualifying subscriber. If a state chooses not to fund all or any of this \$1.75 per qualifying subscriber, federal support would be reduced proportionately, to the floor of \$3.50 per qualifying subscriber. Those states that choose to generate additional support from their own funds, up to \$1.75 per qualifying subscriber, would receive matching federal funding, beyond the \$3.50 per qualifying subscriber floor, of \$5.25 per qualifying subscriber. This proposed modification would, at a minimum, increase federal baseline

^{16/} *Id.* at ¶ 417.

^{17/} *Id.*

support for the Lifeline program without any action on the part of the states, at a level that has less impact upon the overall size of the federal fund than that proposed by the Joint Board.

V. Interstate Subscriber Line and Carrier Common Line Charges

The *Joint Board Recommendations* suggest that current rates for primary residential and single-line business lines are generally affordable,^{18./} a suggestion that the Citizens Companies conditionally accept. However, this conclusion is far from the end of the necessary inquiry. The Citizens Companies note that no exploration has been made of whether rates for universal services can be raised by some margin and still remain affordable to customers-at-large. In addition, the Joint Board's suggestion avoids what is perhaps the most fundamental issue in this proceeding -- are the levels of rates for those services sustainable in the competitive environment in which the new universal service arrangements will operate? A corollary question must also be addressed -- what are the societal and economic costs of maintaining those rates at their present levels? The inescapable economic reality, generally ignored in the *Joint Board Recommendations*, is that the universal service system will ultimately be paid for by all telecommunications services consumers. The due bill may be presented in increased telecommunications rates and increased prices of goods and services provided by commercial telecommunications users. The point is that the increased costs will be passed along to the public in one way or another.

Perhaps the most conspicuous examples of the Joint Board's failure to grapple with the economic and political problems inherent in structuring a new universal service system are its recommendations that: (i) the \$3.50 per month federal subscriber line cap for primary residential

^{18./} *Id.* at Sections V and VI.

and single-line business lines not be increased;^{19/} and (ii), if federal universal service contributions are based on all telecommunications revenues regardless of jurisdiction, one-half of any carrier common line reductions should be apportioned to reduce the federal subscriber line charge on primary residential and single-line business lines.^{20/} The Joint Board apparently believes the federal subscriber line charge to be a subsidy. Instead, that charge represents direct recovery of a portion of the common line cost assigned to the federal jurisdiction. The federal carrier common line charge was developed to recover that portion of the common line cost assigned to the federal jurisdiction that is not recovered by the subscriber line charge. The changes in the carrier common line charge that may come in an access charge reform proceeding will address recovery of the costs of the federal allocation of common line costs. Absent reform of federal-state cost separations, access reform will do nothing to change the level of these costs at the federal level.^{21/}

The Joint Board's position on the federal subscriber line charge fails to acknowledge that the costs of providing universal service do not disappear to the extent that they are not directly recovered from subscribers in the form of local exchange rates and the federal subscriber line charge. Instead, they are socialized. Today, they are generally recovered from implicit subsidy flows from carrier access charges and nonresidential local exchange prices; tomorrow, they will be recovered from

^{19/} *Id.* at ¶ 769.

^{20/} *Id.* at ¶ 773.

^{21/} If strict cost causation principles were followed, that portion of interstate non-traffic sensitive costs now included in federal access charges would be borne by local exchange customers. Unless and until this economic ideal can be achieved, the Citizens Companies agree with the Joint Board's suggestion that interexchange carriers should, in the future, pay a flat-rate charge for the interstate portion of the common line not recovered by the subscriber line charge. The FCC should consider this issue in both this proceeding and the closely-related access reform proceeding.